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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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AUG 25 1993

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

In the Matter of	)	
	)	
Implementation of Sections of	)	MM Docket No. 93-215
the Cable Television Consumer	)	
Protection and Competition Act	)	
of 1992	)	
	)	
Rate Regulation	)	

COMMENTS OF ARTHUR ANDERSEN & CO.

Arthur Andersen hereby responds to your request for comment concerning cost of service regulation for cable operators.[1]

Arthur Andersen provides audit, tax and business advisory services to clients including cable operators of all sizes and a significant number of rate-regulated telecommunications, electric and gas companies. In these capacities, we have an interest in the development of sound regulation and accounting and welcome this opportunity to comment on the Notice.

SUMMARY

Benchmarking against prices charged in competitive markets is, conceptually, a reasonable primary approach for regulating rates of cable operators deemed not subject

[1] Notice of Proposed Rulemaking in MM Docket No. 93-215 released July 16, 1993 (the "Notice").

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to competition. Arthur Andersen and others have documented concerns with the Commission's approach to setting the initial benchmarks and we need not repeat such concerns here. In addition to these concerns, there will be operators which, for a variety of reasons, do not fit the profile for benchmarks. For these operators, an alternative cost of service approach should be available.

As a general rule, we agree that cost of service regulation should serve only to enable cable operators to cost-justify the rates in effect upon enactment of the Cable Act of 1992[2]. It is presumed that such rates were deemed appropriate by cable operators prior to regulation. The imposition of rate regulation alone should not give rise to an increase in rates above such levels. There may be limited situations where cable operators were precluded from charging compensatory rates and specific exceptions may be necessary in these instances.

Traditional cost of service regulation, as it has been applied by the Commission and other Federal and state regulatory agencies, is a logical starting point for cable operators. However, it is important to take into account that cable operators face unique circumstances. Regulation has significantly altered the baseline economics of the cable business. The Commission must give careful consideration to mitigating these effects in designing cost of service regulation for cable operators.

Because cable operators have not previously been subject to cost of service regulation, two major considerations arise. First, original, historical cost is not a universal measure of the value of many cable systems. Through purchases and combinations which have been common to the industry, investor values reflected current fair market values.

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[2] Cable Television Consumer Protection and Competition Act, Pub. L. No. 102-385, enacted on October 5, 1992 (the "Cable Act of 1992").

Consequently, determining cost of service in these situations without giving some recognition to market values will inadequately compensate investors for the capital they provided in good faith.

As a transition mechanism for acquisitions and combinations prior to the Cable Act of 1992, recovery of reasonable "excess acquisition costs" should be allowed. To establish the amount of excess acquisition costs includable in the ratemaking process, we propose the following practical approach:

1. Determine the current value (trended original cost or replacement cost) of cable plant, property and equipment used to provide regulated cable services, and the associated accumulated depreciation, the latter retroactively restated based upon Commission-prescribed lives to the date the Cable Act of 1992 was enacted.

2. Identify, as of the enactment of the Cable Act of 1992, the cumulative, trended customer acquisition costs and the related retroactive accumulated amortization based on an amortization period prescribed by the Commission.

3. The sum of the unamortized amounts obtained in steps 1 and 2 represents an estimate of the current value of property, plant and equipment, and the cost to build the cable operator's customer base. This would act as a "ceiling" for determining the transitional rate base. The cable operator would include such current value amounts in rate base to the extent it could demonstrate it has "paid for" this value (i.e., through "excess" acquisition costs in a business combination for instance).

4. In addition to earning a return on the rate base determined in 3., annual amortization of amounts "paid for" would be included in operating expenses for purposes of determining rates under cost of service regulation.

Going forward, the Commission should establish specific standards which will be used to evaluate excess acquisition costs resulting from subsequent acquisitions and combinations. An appropriate standard would require the cable operator to demonstrate that subscribers will receive benefits and/or cost savings from the transaction.

Second, cable operators generally have not maintained books and records in a manner which will facilitate detailed cost of service filings. Likewise, local franchising authorities (LFAs) are not likely equipped to take on the administrative burden of evaluating rate filings in the custom of Federal and state regulators.

Both factors strongly suggest that the Commission adopt a streamlined, standardized methodology which can be used by LFAs to implement cost of service regulation. A simplified, uniform system of accounts (USOA), prescribed depreciation lives, a generic rate of return, standard cost allocation procedures and a common filing and reporting format will greatly aid all parties. An historical test year with pro forma adjustments for known and measurable changes is the most practical approach.

There are certain costs which require special treatment in the Commission's cost of service methodology. Specific provisions should be made to reflect actual

programming costs and franchise fees in the ratemaking process. Due to their significance, an actual cost tracking mechanism, similar to energy adjustment clauses used to track changes in the cost of fuel sources for electric and gas utilities, should be adopted for programming and franchise costs. While such costs would remain subject to the normal standards of reasonableness and prudency, subscriber rates would automatically be increased or decreased as changes in programming and franchise costs occur and could be shown as a separate item on customer bills.

The costs of complying with the Commission's regulations should be recovered through rates regardless of whether a cost of service or benchmark approach is elected. It is only equitable that the additional costs of complying with regulation be included as a recoverable cost for cable operators which elect cost of service regulation. In addition, costs of regulation are not reflected in the benchmarks which are based on rates in markets subject to competition and therefore not regulated. A separate factor for such costs must be added to the benchmarks to fairly compensate regulated cable operators for the costs of complying with the new regulations. In both cases, it would be appropriate to reflect the recovery of costs of regulation as a separate item on customer bills.

Finally, income taxes incurred related to regulated services should be included as a recoverable cost. The Commission should follow its "stand alone" and "normalization" policies for determining the amount of allowable income taxes. A consistent corporate structure must be assumed for purposes of computing allowable income taxes regardless of the actual tax structure of the cable operator.

Our specific comments on selected issues raised in the Notice are presented below.

REGULATORY GOALS

Overall Goals of Regulation

The Commission has adopted a combination of benchmark, price cap and cost of service approaches for regulating cable service rates.[3] The cost of service requirements are to serve only as a "backstop" for the primary means of regulation, benchmarking.[4]

The Commission has indicated that the principal purpose of cost-based ratemaking in the overall framework of regulation should be to permit regulatory authorities to evaluate whether rates that exceed the benchmark are, based on a cost showing, nonetheless "just and reasonable." Comments were solicited on what the goals of cost of service regulation should be to best form this part of a comprehensive plan for regulating cable operators.

Arthur Andersen agrees in theory that a system of benchmarking based on rates in competitive markets can be reasonable as the primary means of regulating cable operators not subject to competition. Representatives of our firm and other parties have previously commented concerns about the manner in which the existing benchmark rates were determined by the Commission.[5] Since the focus of the Notice is on cost of

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[3] See generally Report and Order and Further Notice of Proposed Rule Making released May 3, 1993 in MM Docket No. 92-266.

[4] Notice at ¶ 7.

[5] See affidavits filed on June 18, 1992 by William Shew, Director of Economic Studies, Arthur Andersen Economic Consulting, in connection with a motion to stay the effectiveness of the rate regulation provisions of the Cable Act of 1992. Our concerns relate to the statistical validity and soundness of the benchmarks and include the following:

- There are inaccuracies in the data used to develop the benchmarks.

service regulation, our comments will not readdress these concerns.

It is worth restating some of the unique characteristics of the cable television industry which make application of traditional cost of service regulation difficult to apply:

- Many cable systems have at one time or another been sold or merged with other systems. Original, historical cost of construction is therefore not a meaningful measure of "cost" from the perspective of many cable operators and investors.

- The cable industry grew up without the existence or expectation of cost of service regulation. As a consequence, recordkeeping was not designed to provide the detailed information normally associated with cost of service filings.

- Capital markets for the cable television industry do not fit the model of those traditionally accessed by rate regulated companies. Financing options, such as limited partnerships, which are commonplace among cable operators, are rarely used for companies in other industries subject to cost of service regulation. This unusual capital structure makes evaluating a "fair" return to investors even more difficult than it is in the conventional regulatory setting.

- The sample of competitive systems used to derive the benchmarks was small.

- A number of the systems included in the sample are owned by municipalities or are engaged in short-term price wars resulting in artificially low prices.

- The vast number of LFAs makes comprehensive cost of service regulation an enormously burdensome process.[6] In most cases, LFAs can be expected to have limited resources available to process cost of service applications which could have the following implications absent streamlined standards and procedures:

  - Delays in the processing of requests for changes in rates.

  - Incentives to negotiate settlements of rate cases which can negate the purpose of a cost of service approach if the end result is largely a political compromise.

  - Skilled resource shortages at LFAs and a resulting proliferation of consultants which adds to the cost of administering cable regulations.

For all of the above reasons, cost of service regulation is probably best suited as a backstop approach. The most likely candidates for cost of service regulation would be cable operators with some or all of the following characteristics:

- Systems which operate in areas of high cost or low population density.

- Systems which have recently been upgraded or rebuilt to incorporate new technology.

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[6] The Commission has indicated there are approximately 33,000 cable community units across the United States which are subject to the jurisdiction of LFAs.

- Systems which were constructed by the present owners and have not been previously sold or combined with other systems.

- Systems which are capitalized in a manner similar to other rate regulated companies (i.e., proportional debt and equity sources) with relatively low cost debt.

- Systems which have detailed original cost and other accounting records.

- Systems of sufficient size to have the administrative resources available to perform and support cost of service filings.

In our experience, the number of cable operators which exhibit all of these characteristics is limited. However, there are a greater number of operators which have several of these attributes. In those cases, the decision to elect the cost of service approach will depend on how well the benchmark reflects the costs of a particular cable system.

Th traditional cost of service approach followed by the Commission and other Federal and state regulators can serve as a useful starting point for designing a system to cost-justify existing rates of cable operators. However, for the reasons previously cited, it will be critical to adapt the traditional approach to accommodate the unique circumstances of cable operators and meet the Commission's primary goal of ensuring just and reasonable rates. We believe that such adaptations should reflect the following supplemental goals:

- To acknowledge that just and reasonable rates are not necessarily synonymous with the lowest possible rates. There must be a balancing between customers and investors which gives appropriate consideration to the risks and costs of providing adequate service.

- To afford transitional treatment to specific items in recognition of the imposition of regulation on cable operators and investors who can demonstrate that prudent business decisions were made prior to regulation.

- To streamline and simplify information which must be developed and filed to support cost of service rates.

- To standardize accounting and reporting as much as possible to provide consistent results.

- To ensure the consistency of regulations prescribed for cable operators with those applicable to potential competitors.

Tier Neutrality

The Commission has tentatively concluded that standards for determining whether cost based rates are reasonable should be tier neutral (i.e., between basic and cable programming services).[7]

[7] Notice at ¶ 11.

Tier neutrality is not an appropriate overall goal because there are cost differences between tiers. On the other hand, tier neutrality offers the advantage of simplicity and is a reasonable goal for costs which cannot be attributed to a specific tier.

Cost based regulation could be required at any level: for the company in total, for a single franchise, for a tier or even for an individual channel. Yet, at each lower level, additional allocations become necessary to derive cost information. Tier neutral rates (i.e., average rates per channel across tiers) would lessen the recordkeeping and cost accounting requirements and reduce incentives to shift costs between tiers to optimize regulatory recovery. However, there are genuine cost differences between tiers which must be recognized in the development of cost based rates. The most obvious example would be programming costs, but other cost differences exist as well. As a result, the Commission should modify its regulatory goal of tier neutrality to instead provide for a methodology which attributes clearly identifiable costs to the appropriate tier and only averages across tiers when costs cannot be causally associated.

REGULATORY REQUIREMENTS

Procedural Requirements for Cost of Service Showings

Filing Frequency Limitations

The Commission proposes to limit the frequency of cost of service filings to once a year.[8]

Limitations on the frequency of cost of service filings would reduce the burden on all parties. There are, however, certain costs which are potentially subject to significant and/or frequent change and are, to some extent, beyond the direct control of cable operators. Examples of such costs are payments for programming and required costs under the franchise agreement. We believe that separate actual cost tracking mechanisms for such amounts will better ensure that prices charged customers reflect actual costs incurred. Our specific proposals in this regard are discussed later in these comments.

If actual cost tracking mechanisms are put in place, cable operators would then be able to set rates to recover other costs less frequently. A period longer than that proposed by the Commission may even be appropriate. In any event, there are several factors which the Commission should consider in setting a limit on the frequency of filings:

- LFA or Commission decisions may be subject to legal appeal for a variety

[8] Notice at ¶ 17.

of reasons and these appeals may not be resolved for extended periods. Therefore, any limit adopted by the Commission should be based on the frequency of filings rather than tied to a period following final decisions.

- As a direct result of franchise negotiations, a cable operator may be required by the LFA or Commission to significantly enhance facilities or the operations of its system. If the resulting additional costs were not considered in the most recent rate application, the time limitation should be waived.

Existing Rates Limits

The Commission requests comment on whether initial cost of service rates should be limited to existing rates absent a demonstration of special circumstances or extraordinary costs.[9]

We believe it is logical to assume that, in most cases, the rates in effect prior to the enactment of the Cable Act of 1992 were acceptable from the standpoint of cable operators. On the other hand, as evidenced by the financial performance of many operators, it is also apparent that the previous rates were not necessarily recovering all costs of the current period. Nevertheless, it seems unlikely that the intent of Congress was to mandate regulations which would result in rates higher than those in effect before regulation. It follows that the rates which were in place upon enactment of the Cable Act of 1992 (prior to any rollbacks) would establish a limit or cap for the initial rates under cost of service regulation.

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[9] Notice at ¶ 18.

The need for an existing rate limit implies that a cable operator has concluded that benchmarks do not adequately reflect the cost of operating its cable system. Cost of service regulation will be employed to cost-justify existing rates rather than to establish the absolute level of new rates. This assumes, of course, that a cost of service determination would produce rates in excess of existing rates and that the cap will thus apply.

There may be limited circumstances which warrant exceptions to the existing rate limit. For example, major upgrades or system rebuilds which were not contemplated in existing rates, as well as other exogenous factors such as a change in the tax law, may be factors which would give rise to such an exception.

Prescribed Rate Filing Package

To simplify the rate filing process and facilitate review, the Commission has proposed that cost of service filings will be made on prescribed forms with supporting worksheets.[10]

Arthur Andersen strongly endorses this proposal. A standardized, prescribed filing package is essential to implementing the goal of streamlined regulation. In our experience, prescribed filing packages have the following advantages:

- They serve as a vehicle for implementing the Commission's rules on the types of costs to be included or excluded in determining revenue

[10] Notice at ¶ 19.

requirements.

- They provide a clear standard for the level of detailed support required. A well designed package provides adequate information to address the needs of all parties and limits the need for ad-hoc supplemental information.

- They pre-format required computations which alleviates confusion among parties unfamiliar with the ratemaking formula.

- They provide information which can be directly compared with prior filings of the same cable operator as well as other operators.

Cost of Service Standards

The Commission tentatively concludes that the overriding standard for cost of service should be the traditional utility model.[11] Under this approach, revenue requirements are equal to the expenses of providing service plus a return on investment.

The traditional rate base, rate of return model for cost of service regulation provides a useful starting point as a backstop to benchmarks. Such an approach must be tailored, of course, to the unique circumstances of the cable television industry. Once rates are initially established under a cost of service filing, the proposed price cap indexing will mitigate many of the well acknowledged concerns with this form of regulation.

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[11] Notice at ¶ 20.

Annual Expenses

Under the Commission's proposal, cable operators will be permitted to recover the annual expenses of providing service including operating expenses, depreciation and taxes.[12]

The Commission's overall conclusion on the composition of annual operating expenses is appropriate. However, unlike rate regulated companies, the accounting systems of cable operators do not presently distinguish between operating and nonoperating activities. Our comments will later address the need for a simplified USOA to draw this important distinction.

Operating Expenses

The Commission defines the types of allowable expenses that cable companies could recover to include plant specific costs (maintenance), plant non-specific costs (programming, power, engineering and testing), customer operations (billing, collection and marketing) and corporate costs (legal, planning, accounting and finance).[13] The proposed categories of operating expenses are consistent with those prescribed by the Commission for telecommunication carriers and appear reasonable as well for cable operators.

Programming Costs

The Commission solicited specific comments on whether a profit or mark-up on

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[12] Notice at ¶ 23.
[13] Notice at ¶ 24.

programming expense should be included in rates and whether cable operators will continue to have sufficient incentives to provide adequate levels of programming service without an allowed profit on such expense.[14]

Costs incurred for non-public access programming should be reflected in operating expenses at their actual amount without mark-up. This is consistent with the basic premise of cost-based regulation under which operating costs are recovered dollar-for-dollar and "profits" are derived from the rate of return applied to the rate base. Unless such programming costs benefit future periods and are capitalized, there would be no basis for adding a profit element to a cost recovered currently.

In the case of costs incurred for public access programming, there is merit to adding a profit element to encourage operators to develop and provide adequate programming of this nature. A reasonable approach to setting the profit level would be to evaluate the average profit margin generated by commercial programmers.

In addition, due to the significance of programming costs to overall operating expenses of cable operators, we recommend that a separate tracking mechanism be established to recover the actual costs incurred. Such a mechanism would be analogous to fuel adjustment clauses used by electric utilities and purchased gas adjustment clauses used by gas utilities to recover the respective costs of fuel and gas. Customer bills typically show a separate line item for the adjustment clause which can be either positive or negative depending on cost trends. These clauses were designed to reduce the need for frequent rate filings to incorporate cost changes in the most significant and volatile expense categories.

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[14] Notice at ¶ 24.

Two alternatives could be considered for a programming cost tracking mechanism. The first would be to include all actual programming costs as a separate line item on subscriber bills and to adjust such amounts whenever changes in actual costs per customer occur. Such changes would arise from revisions to the prices charged by programmers, the movement of programming from one tier to another or the substitution of one form of programming for another within a tier.

A second approach would be to include programming costs in the base rates when initially set under cost of service regulation. Thereafter, a separate line item on the subscriber bill would reflect only the increase or decrease in the per customer programming costs from the amount previously justified by the cable operator in base rates.

Under an automatic adjustment mechanism, the cable operator would still be required to demonstrate that the level of programming costs incurred are reasonable and prudent. Periodically, the cable operator could be required to make a special filing with the LFA or Commission providing information necessary to allow for this evaluation.

Franchise Costs

In many cases, a franchise fee is imposed by the LFA based on revenues derived from operating a cable system. Other franchise costs are determined on other bases. Such costs are often significant and are similar to programming costs in many respects. As a result, we believe it would be equally appropriate to consider actual tracking of such costs in a manner similar to programming costs as described above.

Regulatory Compliance Costs

Cable operators will incur regulatory compliance costs which were not previously contemplated in setting rates. Consequently, under either benchmarking or cost of service approach, it will be necessary to permit cable operators to recover regulatory compliance costs. Such costs would clearly include those related to rate filings, but also should include recordkeeping and other administrative activities which are necessary solely to comply with the Commission's rate regulations. To this end, a specific account with supporting documentation should be required to accumulate regulatory compliance costs. A factor could then be added to benchmarks or cost of service rates to recover these costs.

Special Expenses

The Commission proposes that certain special expenses be excluded from allowable operating expenses. Such costs include lobbying expenses, contributions, membership fees and dues, penalties and fines.[15]

The treatment of these items has been subject to endless debate over the years in the ratemaking arena. A persuasive case can be made that such costs are a normal part of operating any business and should be recoverable for that and other reasons. Yet, it is not uncommon for costs of this nature to be disallowed, in whole or in part, from regulatory recovery.

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[15] Notice at ¶ 24.

A streamlined regulatory approach adopted by the Commission should seek to avoid this debate. First, the Commission should define and establish a single account to record costs of this type. Because such costs are typically relatively minor in relation to total costs, a pragmatic approach is then called for. Possible approaches could include placing an upper limit on the allowable amount in relation to total operating costs or operating revenues, or simply permitting recovery of a specified percentage of costs incurred.

Whatever approach for such costs is adopted by the Commission, it should be made clear that any income tax benefits associated with the portion of such excluded costs also be excluded from the determination of income tax expense. This would be consistent with the methodology used by the Commission for regulating telecommunications carriers and most other regulatory agencies. Our comments with respect to determining allowable income tax expense using the cost of service approach are discussed in a later section.

Capitalization Versus Expense

Generally accepted accounting principles (GAAP) contain general guidance which cable operators can use to determine if costs should be capitalized or expensed. However, because GAAP is not explicit with regard to specific situations, it would be advisable for the Commission to provide more specific guidance in connection with a prescribed USOA. The standards prescribed for telecommunications carriers could serve this purpose.

Depreciation

The Commission tentatively concluded that it should prescribe depreciation rates and solicited comments on whether such prescription should be a composite industry-wide rate, a band of reasonable rates or individual rates for each plant category.[16]

As a simplifying methodology, it is reasonable for the Commission to prescribe generic depreciation lives in lieu of requiring individual depreciation studies by each cable operator. The Commission could prescribe a range of approved lives which would be accepted by an LFA or the Commission for purposes of determining depreciation expense in a cost based rate filing. Such an approach is consistent with recent proposals by the Commission in its proceeding to consider ways to simplify depreciation represcription for telecommunications carriers.[17]

The economic lives of fixed assets should be used to establish prescribed depreciation lives. Like telecommunications companies, cable operators face rapidly changing technology which renders the physical lives of fixed assets a less important factor in determining the useful lives of assets. The Commission must at all costs seek to avoid recreating a depreciation reserve deficiency by prescribing depreciation lives which do not reflect economic lives of fixed assets.

On the surface, an overall composite depreciation rate has appeal because it is simple and straightforward. However, a single rate will not take account differences in the technology of systems (coaxial versus fiber optic cable) and other factors, which could

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16 Notice at ¶ 27.

17 Notice of Proposed Rulemaking released December 10, 1992 in CC Docket No. 92-296.

differ from operator to operator. We believe that it would be preferable to prescribe asset lives for major categories of plant (i.e., head end, cable distribution system, subscriber equipment, etc.).

The depreciation lives and methodology prescribed by the Commission should be consistent with GAAP. The straight-line, remaining life depreciation method is consisent with the GAAP standard to use a "systematic and rational" approach. While GAAP does not specifically address the treatment of cost of removal and salvage value, we believe it is appropriate to recognize such amounts over the useful lives of the assets. This can be accomplished by including a component in prescribed depreciation rates for the estimated net cost of removal/salvage value. This is the practice currently followed by the Commission and most other regulatory agencies.

We would expect that the group method of accounting would be most appropriate for cable operators. Under this approach, gains and losses realized upon normal retirements of fixed assets are charged against the reserve for accumulated depreciation, rather than recognized currently in operating income.

Taxes

The Commission proposes to allow as an operating expense federal and state taxes incurred in the provision of regulated cable television service. Taxes were described as "only those payable by the business entity."[18]

Income taxes should be determined based on GAAP, specifically Statement of Financial

[18] Notice at ¶ 30.

Accounting Standards No. 109, Accounting for Income Taxes. For ratemaking purposes, a simplified computation of the appropriate income tax expense can be made by applying the statutory income tax rates to pre-tax book income from regulated services after considering the effects of "non-temporary" differences between the book and tax basis of assets and liabilities.

Under this approach (sometimes referred to as "normalization" or "comprehensive interperiod income tax allocation") income tax expense will be determined after all of the other elements of cost of service have been considered and determined. Income tax expense is a function of all of the other elements of cost of service—the revenues and expenses deemed appropriate for rate recovery. In this manner, items of cost and expense unrelated to the provision of regulated cable service and therefore not allowed in a cost of service showing (programming costs associated strictly with pay per view service, for example) will be excluded along with the related income tax effects associated with the disallowed cost. This is often referred to as the "stand-alone" approach to determining income tax expense.

The Commission's USOA for telecommunications carriers embraces both the normalization and stand-alone concepts for income tax accounting and ratemaking.[19]

We strongly disagree with the Commission's tentative position that taxes should only include those payable by the business entity. First, such a standard is inconsistent with the Commission's own normalization policy because it only takes into account taxes actually paid in the current period. Second, it is also inconsistent with the Commission's stand-alone tax policy because the tax consequences of regulated

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19 47 C.F.R. Part 32.

operations would not be properly recognized. Tax effects should be consistently determined regardless of the structure of the entity and its investors. To do otherwise would produce inconsistent cost of service results between cable operators solely because of differences in corporate structure. Third, it ignores the fact that investors incur taxes under alternative tax structures. A corporation, partnership or sole proprietorship all incur a tax cost based on the revenues and expenses of business operations. It is only equitable to include a provision for income taxes related to regulated services to compensate investors for this cost.[20]

Rate Base

Plant in Service

The Commission has tentatively concluded that the overall standards for plant in service should be based on original cost, used and useful and prudent investment standards. Comments are also requested on other alternatives used to value rate base, such as market value, reproduction or replacement costs.

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[20] The Federal Energy Regulatory Commission (FERC) has dealt with the issues of rate regulated partnerships in the pipeline industry for many years and more recently covered the subject in an electric utility partnership. Their approach is to provide a "charge in lieu of taxes" on the regulated income of these entities. Like the Commission, the FERC has adopted normalization accounting for income taxes. Under the FERC approach, such entities are treated as if they were corporations for purposes of determining income tax expense for cost of service purposes. Accumulated deferred income taxes on the entities temporary differences are deducted from rate base. This produces lower financing costs and lower revenue requirements as such amounts provide "interest free" capital from the U.S. Treasury. (See, for instance, Docket No. ER 87-23-000 re: Ocean State Power, Docket No. CP89-983-000 re: Riverside Pipeline Company, L.P., Docket Nos. CP-87-479-000 and CP87-480-000 re: Wyoming-California Pipeline Company and Docket Nos. CP74-299 and CP74-290 re: Alaskan Arctic Gas Pipeline Company and Northern Border Pipeline Company.)

Over the years, Arthur Andersen has advocated a current value (such as trended original cost) approach to value rate base. We continue to believe that a current value approach is superior to original, historical cost. In this case, a current value approach would resolve issues that arise from acquisitions and combinations as well as limitations in historical accounting records.

The changing policies of Congress towards regulating the cable industry have affected the economics of the business. The issue of what to do with excess acquisition costs that arose during the deregulated phase from 1984 through 1992 is a thorny one. On one hand, cable operators will no doubt argue with conviction that acquisitions during this period were made at arms length, and therefore reflect fair market values which should be recoverable in full. Others will most likely assert that customer rates should not be affected solely by changes in ownership.

The resolution of this threshhold issue boils down to a question of fairness. While we view the Commission's tentative conclusion to adopt original cost standards for plant in service as untenable given the unregulated environment in which many cable system acquisitions were made, other parties with more direct interests in the outcome are in a better position to advocate the two sides of the debate. Our comments seek instead to present a middle ground alternative for the Commission to consider which reflects our views on current value and, to some extent, regulatory precedent. Our proposed alternative is to follow a transitional approach for excess acquisition cost which relate to transactions which were consumated prior to the enactment of the Cable Act of 1992. For subsequent acquisitions, the traditional "customer benefit" standard would be used to evaluate the recoverability of excess acquistion costs.